



**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CAL**

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The Utility Reform Network,

Complainant,

vs.

Pacific Bell Telephone Company d/b/a AT&T  
California (U 1001 C); AT&T  
Communications of California, Inc.  
(U 5002 C),

Defendants.

Case No. C.13-12-005

**ANSWER AND DEFENSES OF PACIFIC BELL TELEPHONE COMPANY (U 1001 C)  
d/b/a AT&T CALIFORNIA TO THE COMPLAINT**

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**ANSWER AND DEFENSES OF PACIFIC BELL TELEPHONE COMPANY (U 1001 C)  
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Pacific Bell Telephone Company, doing business as AT&T California (“AT&T California”),<sup>1</sup> respectfully submits its Answer and Defenses to the Complaint of The Utility Reform Network (“TURN”).

**I. INTRODUCTION**

TURN alleges that AT&T California’s rates for residential basic local exchange service (“basic service”) are unjust and unreasonable and should be reduced and subjected to price caps. The Complaint, however, is fundamentally at odds with the Commission’s Uniform Regulatory Framework (“URF”), which gave AT&T California full pricing flexibility for basic services. *Order Instituting Rulemaking on the Commission’s Own Motion to Assess and Revise the Regulation of Telecommunications Utilities*, D.06-08-030, 2006 WL 2527822 (Aug. 24, 2006) (“*URF Order*”). TURN alleges no fact that, even if true, would in any way show that URF is not working and competition has failed. Instead, TURN asks the Commission to shoot first and ask questions later: it wants the Commission to *first* declare that AT&T California’s rates are unjust and unreasonable and impose price caps, and only *later* evaluate the state of competition and effectiveness of URF. Complaint ¶¶ 58-64, 71.

That is backwards at best. When granting full pricing flexibility to the four largest incumbent local exchange carriers (“ILECs”) under URF (AT&T California, Verizon, SureWest, and Frontier), the Commission found that AT&T California has no market power and that competition will ensure just and reasonable rates. *URF Order*, D.06-08-030 at 117, 182, 265. It

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<sup>1</sup> AT&T California is answering TURN’s Complaint only on its own behalf. Although the Complaint refers to “AT&T” in a vague manner, without specifying which defendant it refers to, AT&T California will assume for purposes of AT&T California’s Answer that each reference to “AT&T” refers only to AT&T California. To the extent any references to “AT&T” in the Complaint are meant to refer to AT&T Corp. (formerly AT&T Communications of California, Inc.), AT&T California refers the Commission to AT&T Corp.’s separate Answer to the Complaint.

would make no sense to preemptively take away AT&T California's pricing freedom based on TURN's purported comparison points, which were never endorsed in any decision as limiting pricing flexibility under URF, and are irrelevant to assessing AT&T California's market-based rates.

In any event, TURN's real goal seems to be to have the Commission initiate an overall general review of competition. AT&T California does not object to the Commission initiating a general review of competition in another forum if the Commission truly believes a review is necessary. That, however, is an entirely separate matter from TURN's groundless Complaint.

**A. The Commission's Uniform Regulatory Framework Eliminated All Rate Caps and Cost-of-Service Regulation and Gave AT&T California Freedom to Set Its Own Rates in the Competitive Market**

In the *URF Order* in 2006, the Commission recognized that the voice communications market had changed dramatically over the 18 years since its previous review of the telecommunications regulatory framework, and the market now includes not only traditional wireline carriers, but also wireless carriers, cable companies, VoIP providers, and other emerging technologies. The Commission also found that federal and state legislation favor competition and market-based pricing over regulated pricing and that AT&T California and the other URF ILECs (Verizon, SureWest, and Frontier) lacked market power over voice service and therefore could not sustain prices above a competitive level. *URF Order*, D.06-08-030 at 4-5, 117, 182, 265. In light of these findings, the Commission made the watershed decision that competition – not price caps or cost-of-service principles – would be used to govern rates for most retail services, including basic service. The Commission explained that “price controls skew competitors’ interests, and they discourage true intermodal competition for voice services, including basic residential service” and “are incompatible with the emergence of competition in the voice communications market.” *Id.* at 152, 267 (FOF 67). The Commission, however,

temporarily extended the cap for stand-alone basic residential service “in order to address the statutorily mandated link between the LifeLine rate and basic residential service rates.” *Id.* at 2.

**B. The Transition to Full Pricing Flexibility for Basic Residential Services**

In Decisions 07-09-020 and 08-09-042, the Commission adopted a framework for the transition of basic residential service to market-based rates. The Commission recognized that regulated rates for basic service were “significantly outdated” and had been kept so “abnormally low” for so long that prices would increase sharply when they moved to market levels, and that rate shock could occur if prices were allowed to immediately increase to that level. *Order Instituting Rulemaking into the Review of the California High Cost Fund B Program*, D.08-09-042, *Decision Adopting Phased Transition Plan for Pricing Basic Telephone Service*, mimeo, at 22-24 (Sept. 18, 2008) (“*Transition Order*”). For example, AT&T California’s rates had been frozen since 1995 at a level recovering just half the regulatory cost of providing service. *Id.* at 8.<sup>2</sup> The Commission therefore adopted a two-year transition period, 2009-2010, during which it capped the permissible rate increases each year. *Id.* at 4. After that period, the URF ILECs were given “full pricing flexibility” for basic service starting on January 1, 2011. *Id.* at 5.

**C. The Commission Expected That Prices Would Increase as Rates Moved From an Artificially Low Regulated Level to a Market Level, But Found That Pricing Freedom Was the Best Way to Promote Robust Competition**

The Commission fully expected that rates would likely increase as they moved to a market level under full pricing flexibility, recognizing that “with the passage of time since the basic rate freeze took effect in 1995, existing rate levels are significantly outdated,” and that rate increases would be “necessary” to make prices “consistent with today’s intermodal market realities.” *Id.* at 22, 23. But the Commission did not see that as a problem. As it explained, rate

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<sup>2</sup> The formula the Commission used was:  $FAC - EUCL / 2$  (Fully Allocated Cost minus EUCL, divided by 2). *Re Alternative Regulatory Frameworks for Local Exchange Carriers*, D.94-09-065, 56 CPUC2d 116, 1994 WL 780935, at \*25 (Sept. 15, 1994).

increases during and after the transition period are “sensible in light of market conditions.” *Id.* at 30-31. The Commission also found that restricting pricing freedom in any way would be harmful because it “would unduly impede progress toward unimpeded competitive market pricing,” and “there is no valid basis to perpetuate anachronistic rate levels that distort prices.” *Id.* at 29. “Particularly in view of the extended period that basic rates remained frozen despite changing market dynamics, allowing for increases in basic rates is appropriate and fair.” *Id.* at 24. “[I]t is reasonable to allow basic rates to adjust to levels dictated by competitive market forces, thereby promoting economic efficiency.” *Id.* at 25. The Commission also saw no problem with expected rate increases because “market forces will provide an effective check to keep any subsequent rate adjustments after January 1, 2011 at affordable levels.” *Id.* at 42.

**D. TURN Seeks To Impose Price Caps on Basic Residential Service Based on Flawed and Irrelevant Comparisons**

TURN now attacks AT&T California’s rates as being unlawfully “unjust and unreasonable,” relying on a series of comparisons that, it claims, proves AT&T California’s rates are unjust and unreasonable. These comparisons are meaningless. No Commission decision has adopted any of the measures TURN uses as limiting AT&T California’s pricing flexibility in any way. Indeed, accepting any of TURN’s comparisons as limiting AT&T California’s pricing flexibility would make those figures a *de facto* rate cap, yet that directly conflicts with URF’s goal of eliminating all rate caps, which impede competition. *Id.* at 12, 26 (“We do not intend to apply rate caps any longer than is reasonably necessary to promote an orderly transition to full pricing flexibility” starting January 1, 2011; “[O]ur goal is to phase out all rate caps.”); *URF Order*, D.06-08-030 at 152 (“Price controls skew competitors’ interests, and they discourage true intermodal competition for voice services, including basic residential service.”). As the

Commission recognized, “ILECs should be allowed to adjust the basic rate to meet their unregulated competition in a flexible manner.” *Transition Order*, D.08-09-042 at 6.

TURN first asserts that AT&T California’s basic exchange service rates have “skyrocketed” since 2011. Complaint ¶¶ 27-28, 44-47. While AT&T California’s rates have increased since 2011, that is exactly what the Commission expected, as explained above. Further, measuring the percentage rate increase from that artificially low starting point is meaningless, for it tells nothing about whether the current rate exceeds market levels. TURN’s attempt to use *regulated* rates to gauge the reasonableness of *unregulated* rates makes no sense.

TURN next asserts that AT&T California’s rates are above those of the other URF ILECs even though AT&T California allegedly has lower costs of service. Complaint ¶¶ 29-32. Nothing in any of the URF orders, however, restricts pricing freedom based on the rates or alleged costs of other URF ILECs. To the contrary, the URF decisions expressly rejected any cost-of-service measures or rate caps. *Transition Order*, D.08-09-042 at 12, 22, 26; *URF Order*, D.06-08-030 at 152. Under URF it is market conditions that dictate rates, not other carriers’ alleged costs, and the Commission expected variation among the URF ILECs. *Transition Order*, D.08-09-042, at 35, 44 (“Competitive forces, income levels and costs vary by specific region, and thus, some disparities will be expected and normal”; “adjustments in the basic rate will be a function of competitive influences, marketing strategies of the ILEC, as well as actual changes in costs and technologies over time”). Moreover, even if comparisons to rates of other URF ILECs were relevant, during the transition period the Commission authorized each of the other URF ILECs to charge basic service rates of over \$24 in 2010 (ranging from \$24.16 for Verizon to \$25.40 for SureWest), which is higher than AT&T California’s current rate.<sup>3</sup> *Id.* at Appendix 2.

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<sup>3</sup> AT&T California’s current rate for basic residential flat-rate service is \$24.

TURN further relies on its claim that AT&T California's rates are above the regulated rates of ILECs that serve high-cost areas and receive subsidies from CHCF-A. Complaint ¶¶ 33-37. That compares apples and oranges. The small ILECs serving these high-cost areas are subject to rate-of-return regulation; AT&T California is not. Those ILECs' rates also are capped to keep them artificially low; AT&T California's are not. Nothing in URF requires statewide parity of rates among all ILECs or restricts URF ILECs' prices based on non-URF ILECs' rates.

TURN's claim that AT&T California's rate increases exceed the rate of inflation is similarly meaningless. Complaint ¶¶ 38-43. Nothing in any of the URF decisions requires basic service rates to only increase at or below the rate of inflation. To the contrary, as explained above, rates were kept artificially low from 1995 through the transition period, so it cannot come as a surprise that subsequent increases would exceed inflation as rates caught up to market levels. And even if the rate of inflation were relevant, applying that rate to AT&T California's full allocated costs in 1995 (not to *half* those costs, as TURN does), yields a cost today of \$40.89 per month, well above AT&T California's current rates.<sup>4</sup>

Finally, TURN's contention that AT&T California's price increases for other non-basic services have any bearing on the reasonableness of basic service rates (Complaint ¶ 38-40) is, once again, irrelevant. Nothing in the Commission's decisions made pricing flexibility contingent on rate freezes or decreases for non-basic services.

#### **E. TURN's Complaint Is Simply the Latest in a Series of Attempts to Undermine URF**

TURN's attack on URF is nothing new, for TURN has consistently attempted to undermine the pricing freedom granted in URF in the past. And the Commission has just as consistently rejected those attempts. In the proceeding that led to the adoption of URF, TURN

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<sup>4</sup> This figure is obtained using the CPI inflation calculator maintained by the Bureau of Labor Statistics at [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm).



asked the Commission to continue to “regulate and monitor” ILECs’ service prices, but the Commission rejected TURN’s proposal as “burdensome and unnecessary in light of the affected ILECs’ lack of market power.” *URF Order*, D.06-08-030 at 183-84. In 2008, TURN opposed the rate increases allowed under URF during the transition period, arguing that even those rates were unreasonable. The Commission disagreed, finding that TURN had “disregard[ed] the record in the URF proceeding,” which showed that URF ILECs “lack the market power needed to sustain prices above the levels that a competitive market would produce.” *Transition Order*, D.08-09-042 at 33. Later in 2008, TURN filed in support of a Petition by the Division of Ratepayer Advocates (“DRA”) to modify the *URF Order* to impose price controls on basic residential rates.<sup>5</sup> The Commission summarily dismissed DRA’s 2008 Petition by closing the URF docket in D.09-11-015, finding the “[a]ll substantive issues outlined in the scoping memorandum for this rulemaking have been resolved.” *Re Assess and Revise the Regulation of Telecommunications Utilities, Decision Closing Docket on Commission’s Own Motion*, D.09-11-015, *mimeo*, at 5, 2009 WL 4458576 (Nov. 20, 2009). In 2010, TURN filed in support of yet another DRA Petition asking the Commission to impose price controls on basic residential rates.<sup>6</sup> DRA’s Petition was denied.<sup>7</sup> TURN’s Complaint should similarly be dismissed.

## **II. ANSWER TO SPECIFIC ALLEGATIONS**

1. **TURN’s Allegation:** Pursuant to Public Utilities Code Section 1702 and Rule 4.1(b) of the Commission’s Rules of Practice and Procedure, The Utility Reform Network (TURN) hereby brings this Complaint regarding the unreasonable basic exchange service rates of

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<sup>5</sup> Response of The Utility Reform Network to Petition of DRA for Modification of D.06-08-030 relating to Price Controls on Basic Residential Rates and to Monitoring of Competition (filed August 28, 2008, in R.05-04-005).

<sup>6</sup> Comments of the Utility Reform Network on the Petition of the Division of Ratepayer Advocates for Modification of Decision 08-09-042 Relating to the Price Controls on Basic Residential Rates (filed Nov. 29, 2010 in R.06-06-028).

<sup>7</sup> Assigned Commissioner’s Ruling Dismissing Petition for Modification and Granting Motion to Dismiss (Dec. 21, 2010 in R.06-06-028).

Pacific Bell Telephone Company D/B/A/ AT&T California (U1001C) and AT&T Communications of California (U5002C) (collectively AT&T). In accordance with Section 1702 and Rule 4.1(b), attached to this complaint as Appendix A are the signatures of more than 25 current consumers of AT&T's basic exchange services in support of this Complaint.

**AT&T California's Answer:** Pacific Bell Telephone Company d/b/a AT&T California ("AT&T California") admits that TURN purports to bring a complaint alleging that AT&T California's basic exchange service rates are unreasonable. AT&T California lacks sufficient information or belief to admit or deny that the signatures included in Appendix A to the complaint satisfy the requirements of Section 1702 and Rule 4.1(b), and on that basis denies that the signatures satisfy those requirements.

2. **TURN's Allegation:** TURN is compelled to bring this complaint because of the dramatic increases to the rates for AT&T's residential flat and measured rate basic exchange service (collectively "basic exchange services" or "basic services") since the Commission has begun relying on market forces to constrain AT&T's rates. Traditionally the incumbent local exchange carrier ("ILEC") with the lowest residential basic service rates in California, AT&T's rates have now skyrocketed to the highest levels of all ILECs, as shown in Table 1. [Table and footnote 1 omitted.]

<sup>2</sup> In this chart, "A Fund" refers to those carriers that draw subsidy funding from the California High Cost Fund-A. These carriers are incumbent local exchange carriers, regulated by a rate of return framework, that serve smaller, higher cost service areas in the state not served by the four largest incumbent carriers.

**AT&T California's Answer:** AT&T California admits that the rates listed in Table 1 and described in footnote 1 appear to be correct, except for AT&T Measured Rate service, which

should have been \$18.25 and not \$18.35 as listed in Table 1.<sup>8</sup> Regarding footnote 2, AT&T California admits on information and belief that the first sentence of footnote 2 is correct and that CHFC-A ILECs are regulated by a rate-of-return framework, but AT&T California lacks sufficient information or belief to admit or deny the allegation regarding those carriers' costs, and on that basis denies the allegation. AT&T California denies the remaining allegations of paragraph 2. Among other things, the reference to "Traditionally" is unclear.

3. **TURN's Allegation:** As shown in Figures 1 and 2 below, in the two years since AT&T began enjoying full deregulation of basic service rates on January 1, 2011, AT&T's flat and measured service rates have increased 40% and 73% respectively. And since January 1, 2009, when the Commission granted major increases to the price caps for ILEC basic service rates, AT&T's flat and measured service rates have increased a striking 115% and 222% respectively. These increases to AT&T's basic rates all flow from the Commission determination in Decision (D.) 06-08-030 that competitive forces could be relied upon to keep ILEC basic rates at just and reasonable levels. [Footnote omitted.] [Figures omitted.]

**AT&T California's Answer:** AT&T California denies the allegations of the first two sentences of paragraph 3, as AT&T California has not been able to replicate TURN's calculations. The third sentence of paragraph 3 purports to characterize Commission Decision 06-08-030, which Decision speaks for itself.

4. **TURN's Allegation:** Competitive forces are not imposing sufficient constraints to ensure that AT&T's basic service rates meet the requirement of Public Utilities Code Section 451 [Footnote omitted.] that "all charges demanded or received" by a public utility such as

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<sup>8</sup> As of January 1, 2014, AT&T California changed its rate for flat-rate basic exchange service to \$24.00 and for measured service to \$21.25. All responses in this AT&T California's Answer, however, address the rates as set forth in TURN's Complaint as of the time it was filed.

AT&T “shall be just and reasonable.” (Emphasis added.) AT&T’s basic service rates fail to meet the just and reasonable standard for at least the following reasons:

- AT&T is the largest California carrier serving the largest urban areas of the state, AT&T traditionally has had the lowest, cost-based regulated rates of any of the four biggest ILECs in the state, as shown by the 2006-2008 rates in Figures 1 and 2. Now, after deregulation, AT&T’s basic rates have skyrocketed to the highest levels in California – higher even than SureWest and Frontier, whose cost-based regulated rates used to be the highest of the four carriers. AT&T’s flat and measured rates now surpass SureWest’s by 15% and 31% respectively and exceed Frontier’s flat and measured rates by 21% and 39% respectively.
- AT&T’s current \$23.00 rate for flat service has also shot above the current regulated rate of \$20.25 for carriers who wish to obtain funding from the California High Cost Fund A (“A Fund”). Traditionally, in recognition of their high cost service territories, A Fund carriers were required to charge much higher rates than AT&T -- 150% of AT&T’s rates -- for their residential flat services. Now, it is AT&T that is imposing the highest rates.
- AT&T’s rate increases dramatically outpace the rate of inflation. In just four years after rate deregulation began, AT&T’s flat and measured rates increased 115% and 222%, respectively, even though the aggregate increase in the consumer price index (“CPI”) was just 7%. [Footnote omitted.] And, since AT&T was given full pricing freedom on January 1, 2011, its flat and measured rates have increased by 40% and 73%, as compared to aggregate inflation in that two-year period of just 5%. [Footnote omitted.]

**AT&T California’s Answer:** AT&T California denies the allegations of the first two sentences of paragraph 4. AT&T California admits that it is the largest California incumbent local exchange carrier (“ILEC”), serving some of the largest urban areas of the State (among other places); admits that in the past its regulated basic rates were set far below cost and were the lowest of the four largest ILECs; admits that its basic rates are now higher than the other three largest ILECs; admits that its flat basic rate exceeded SureWest’s by 15% and Frontier’s by 21%; and admits that a \$23.00 rate for flat service exceeded the current regulated, subsidized rate of \$20.25 for carriers who obtain California High Cost Fund A funding, which carriers in the past were required to charge higher rates than AT&T California. AT&T California has not been able to replicate or verify TURN’s other calculations and on that basis denies them. AT&T California

denies all remaining allegations of paragraph 4. Answering further, AT&T California states that none of the comparisons cited by TURN are relevant and the Commission did not adopt any of them as a limitation on AT&T California's rates under URF.

5. **TURN's Allegation:** In D.06-08-030, the Commission pledged to "remain vigilant" in monitoring the California voice marketplace and to ensure that basic residential service "does not trend above the current highest basic residential rate in the state, no matter the technology employed to offer such service." [Footnote omitted.] AT&T's basic residential service rates are not just "trending" above the highest basic rates when those words were written in 2006 – SureWest's \$18.90 flat rate – they are skyrocketing above the current rates of SureWest, Frontier, and the A Fund LECs, all of whom, on average, serve much higher cost exchanges than AT&T. If competition were effectively constraining AT&T's basic rates, such frequent and sharp rate increases would not be possible.

**AT&T California's Answer:** The first sentence of paragraph 5 purports to characterize D.06-08-030; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. AT&T California lacks sufficient information or belief to admit or deny the allegation about relative costs of other carriers, and denies the allegation on that basis. AT&T California further notes that the alleged cost of service of it or other ILECs is irrelevant, as the Commission does not limit URF ILECs' rates based on cost of service (indeed, the Commission does not set rates for URF ILECs at all) and did away with cost-of-service regulation in the late 1980s. *Transition Order*, D.08-09-042 at 7. AT&T California denies the remaining allegations of the second and third sentences of paragraph 5.

6. **TURN's Allegation:** AT&T is able to impose these unbridled rate increases on services that remain vital to a significant number of California's consumers of voice

communications service. The most recent CPUC Communications Division (“CD”) Market Share Analysis found that almost one-quarter of California households rely solely on traditional wireline phone service for their voice communications. [Footnote omitted.] And 2011 data from the federal government shows that over half of California households regularly use landline service, either solely or in combination with wireless service. [Footnote omitted.] Many households subscribe to traditional wireline service as a complement to wireless or voice over Internet protocol (“VOIP”) services because of the traditional service’s important advantages in call quality and reliability in a power outage. Thus, even though subscription to basic services may be declining, residential voice service is still important and warrants the continued vigilance the Commission promised in 2006.

**AT&T California’s Answer:** AT&T California denies that it has imposed or is able to impose “unbridled rate increases,” and notes that the Commission held in D.06-08-030 that AT&T California lacks market power and therefore has no ability to sustain rates above a competitive level. TURN does not and could not allege that AT&T California now has market power or that competition for voice service has ceased to exist. AT&T California admits that the CD’s Market Share Analysis based on 2009 data found that 24% of California households rely solely on traditional wireline phone service for voice communications, and admits that a federal government survey estimated in 2011 that 50.5% of California households fell within the categories cited by TURN regarding landline service. Answering further, AT&T California notes that Table 2 of the federal government study cited in TURN’s Complaint, which appears to rely on more recent data, indicates that only 7.8% of adults in California use “Landline only” service. AT&T California lacks sufficient information or belief to admit or deny the fourth sentence of paragraph 6 and therefore denies it. AT&T California admits that subscription to

basic landline service has been declining, but otherwise states that the last sentence of the paragraph is merely a statement of TURN's opinion, not an allegation of fact, and requires no response. To the extent that sentence is deemed to contain any factual allegation, AT&T California denies it.

7. **TURN's Allegation:** The Commission has made clear that Section 1702 complaints such as this one are the appropriate means to "have the Commission consider whether rates and charges of a service are no longer just and reasonable for a particular carrier." [Footnote omitted.] AT&T's rates cannot meet the just and reasonable standard when they are higher than the rates of SureWest, Frontier, and the A Fund LECs, carriers that are known to have much higher average costs to serve than AT&T. Accordingly, based on the record in this case, the Commission should order a reduction in AT&T's basic service rates to the current levels of SureWest (which has higher rates than Frontier) -- \$20 for flat service and \$14 for measured service. [Footnote omitted.] In conjunction with this Complaint and in recognition of the rule against retroactive ratemaking, TURN is filing a Motion for the Establishment of a Memorandum Account for AT&T's Basic Services ("Motion") to establish a date after which AT&T will be responsible for refunding to its ratepayers the portion of basic service rates that are determined in this case to exceed just and reasonable levels. Therefore, once the Commission concludes that AT&T's rates are not just and reasonable, it should: (1) order AT&T to reduce AT&T's rates at that time to just and reasonable levels, i.e., no higher than the current SureWest rates; and (2) order refunds to AT&T customers for the excessive rates charged during the period between the date of the decision ordering the memorandum account requested by TURN's Motion and the implementation of the new just and reasonable rates ordered in this proceeding.

**AT&T California's Answer:** AT&T California denies the allegations of paragraph 7, and denies that TURN is entitled to the relief requested therein. Among other things, TURN's complaint fails to state any claim against AT&T California and fails to specifically state any facts that, if true, would demonstrate that any of AT&T California's basic service rates are not just and reasonable. AT&T California further denies that a memorandum account would be appropriate or lawful here.

8. **TURN's Allegation:** In addition, the Commission should promptly initiate the long-promised (since the end of 2010) and long-deferred review of the status of competition in the California telecommunications marketplace. [Footnote omitted.] The review should include a determination of the reasons why competition has failed to ensure that AT&T's basic rates remain just and reasonable and whether such factors apply to other California ILECs. The reduced rates ordered upon the Commission's finding in this case that the rates are not just and reasonable should remain capped at those reduced levels until the Commission concludes its competition review and determines whether changes to the regulation of ILEC basic rates are needed. The review should also include an examination of whether AT&T and other holders of a state video franchise are using increases to stand-alone basic service rates to subsidize their video services, contrary to Section 5940 of the Digital Infrastructure and Video Competition Act of 2006 ("DIVCA").

**AT&T California's Answer:** AT&T California denies the allegations of paragraph 8, and denies that TURN is entitled to the relief requested therein. Among other things, TURN's complaint fails to state any claim against AT&T California and fails to specifically state any facts that, if true, would demonstrate that any of AT&T California's rates are not just and reasonable. Nor has TURN stated any facts that, if true, would demonstrate that any holder of a



state video franchise has violated Section 5940 of DIVCA. Answering further, AT&T California states that it has no objection to the Commission undertaking a review of the status of competition. However, if the Commission does initiate such a review, there is no basis for including a review of compliance with Section 5940 of DIVCA as TURN has not alleged a single fact that suggests a violation of Section 5940, and hence there is no basis for TURN's proposal.

9. **TURN's Allegation:** The transition from capped ILEC basic service rates to fully deregulated rates spanned several decisions over several years. Throughout this process, the Commission emphasized that it would remain vigilant in monitoring the results of rate deregulation and that complaints such as this would be important to the Commission's efforts to ensure just and reasonable rates for basic services.

**AT&T California's Answer:** AT&T California admits the first sentence of paragraph 9. As to the second sentence, AT&T California denies that TURN's complaint is "important" to the Commission's efforts to ensure just and reasonable rates for basic services. Among other things, TURN's complaint fails to state any claim against AT&T California and fails to specifically state any facts that, if true, would demonstrate that any of AT&T California's rates are not just and reasonable.

10. **TURN's Allegation:** Prior to 2006, under various regulatory structures, ILEC basic service rates were fixed by Commission regulation for all California ILECs. As the Commission has previously explained, in 1995 and 1996, the Commission froze basic service rates at levels designed to recover approximately one-half of the ILEC's costs, with all other rate elements to recover the remaining costs of service. [Footnote omitted.] For many years prior to

2006, the basic service rates for the four largest ILECs (excluding surcharges and surcredits) were as follows: [table omitted]

**AT&T California's Answer:** AT&T California admits the allegations of the first sentence of paragraph 10. Regarding the second sentence, AT&T California states that the Commission's prior rate decisions speak for themselves and require no further response. AT&T California admits the remaining allegations of the paragraph.

11. **TURN's Allegation:** Thus, reflecting its relatively low cost service territory and economies of scope and scale, AT&T's cost-based basic service rates were well below those of all the other ILECs in California. The closest flat rate, \$17.25 for Verizon, was 53% higher than AT&T's cost-based flat rate. With the exception of AT&T, whose basic rates were further reduced in subsequent years – to \$10.69 for flat service and \$5.70 for measured service -- these rates remained in effect when the Commission issued its deregulatory Uniform Regulatory Framework ("URF") decision, D.06-08-030. [Footnote omitted.]

**AT&T California's Answer:** AT&T California denies the allegations of the first sentence of paragraph 11. Its basic service rates were not "cost-based," because those rates instead were for many years held at artificially low levels far below AT&T California's regulatory costs. For the same reason, AT&T California denies the allegation of the second sentence of paragraph 11 that its flat rate was "cost-based." AT&T California admits the remaining allegations of this paragraph.

12. **TURN's Allegation:** In D. 06-08-030, the Commission determined that AT&T, Verizon, SureWest and Frontier ("the URF LECs") lacked market power in their service territories and that price regulation was no longer necessary to keep their basic service rates at just and reasonable levels. [Footnote omitted.] The decision granted those carriers broad pricing

freedoms for almost all services, including residential basic exchange services. [Footnote omitted.] However, the CPUC delayed removing the cap on residential basic services until September 1, 2009, to allow the Commission time to “carefully consider very important public policy issues relating to the basic rate in our Universal Service docket.” [Footnote omitted.] In support of its conclusion that pricing freedoms were warranted, the Commission found that FCC unbundling policies, aided by competition from wireless and voice over Internet protocol (“VOIP”) technologies, served to prevent the ILECs from raising prices above just and reasonable levels. [Footnote omitted.] The Commission vowed to keep a close watch on the impacts of its decision, particularly on basic services:

Finally, we will remain vigilant in monitoring the voice communications marketplace. We will ensure that basic residential service remains affordable and *does not trend above the current highest basic residential rate in the state*, no matter the technology employed to offer such service. Should we see evidence of market power abuses, we retain the authority and firm resolve to reopen this proceeding to investigate such developments promptly. [Footnote omitted.]

**AT&T California’s Answer:** Paragraph 12 purports to quote from and characterize the Commission’s Decision 06-08-030. AT&T California denies that TURN has fully and accurately characterized that Decision, and states that the Decision speaks for itself. Answering further, AT&T California notes that in the *Transition Order*, D.08-09-042, the Commission authorized AT&T California and the other URF ILECs to adopt basic residential service rates higher than the highest basic residential service rate of any URF ILEC at the time of the *URF Order*, D.06-08-030. In fact, the *Transition Order* (D.08-09-042 at Appendix 2) authorized Verizon, SureWest, and Frontier to adopt basic service rates in 2010 ranging from \$24.16 for Verizon to \$25.40 for SureWest (excluding the EUCL), each of which exceeds AT&T California’s basic service residential rate today. While TURN’s comparisons between the rates of URF ILECs are not relevant, the fact that the Commission deemed such rates to be reasonable

as of January 1, 2010 means that TURN cannot claim AT&T California's *lower* rate in 2014 is unreasonable.

13. **TURN's Allegation:** Thus, the Commission pledged to pay particular attention to basic service rates and to ensure that such rates would not "trend above" the highest current basic rates in the state. At that time, the highest rates for flat service were those of SureWest at \$18.90, which was 77% higher than AT&T's \$10.69 monthly rate.

**AT&T California's Answer:** The first sentence of paragraph 13 purports to characterize the Commission's Decision 06-08-030. AT&T California denies that TURN has fully and accurately characterized that Decision, and states that the Decision speaks for itself. See also the answer to paragraph 12. AT&T California admits the second sentence of paragraph 13.

14. **TURN's Allegation:** In D.07-09-018, the Commission held that consumers may not protest on the grounds of reasonableness rate increases proposed by advice letter for services that are no longer price regulated by virtue of D.06-08-030. Importantly, however, the Commission explained that consumers still had recourse to challenge the reasonableness of rates:

The inability to file a protest as to rates does not, however, foreclose consumers' rights to complain that rates are not just and reasonable. Pursuant to Pub. Util. Code Section 1702, and Commission's Rules of Practice and Procedure Rule 4.1, a party may complain as to the reasonableness of any rate or charge, and bring such complaint before the Commission. This procedure affords consumers the opportunity to have the Commission consider whether rates and charges of a service are no longer just and reasonable for a particular carrier. In such a complaint proceeding, the Commission may determine whether conditions have changed for that carrier. [Footnote omitted.]

**AT&T California's Answer:** Paragraph 14 purports to quote from and characterize the Commission's Decision 07-09-018. AT&T California denies that TURN has fully and accurately characterized that Decision, and states that the Decision speaks for itself. AT&T California further answers that in D.07-09-018, the Commission concluded that opponents could not file protests to advice letters to challenge increases to deregulated rates, but reaffirmed that

complaints may be filed alleging a carrier's rates are unjust and unreasonable in violation of law. However, the Commission did not suggest that such complaints can simply be filed in lieu of an advice letter protest and may proceed regardless of whether they set forth sufficient facts to state a claim. Moreover, the Commission noted in Decision 08-04-063 (at 8) that "there are also alternative procedures such as a petition for modification of the decision, a rulemaking, or a Commission ordered investigation in which we may determine whether conditions have changed to an extent to necessitate revisiting findings in a prior Commission decision." In any event, TURN's contentions fail to state a claim for a complaint case.

15. **TURN's Allegation:** Thus, the Commission has made clear that complaints such as this one are the appropriate vehicle to challenge the reasonableness of AT&T's basic service rates.

**AT&T California's Answer:** Denied.

16. **TURN's Allegation:** In the course of ordering reforms to the California High Cost Fund –B ("CHCF-B"), D.07-09-020 permitted AT&T and Verizon, to raise their basic service rates by 2.36% (the rate of inflation under the CPI-U), effective January 1, 2008.

[Footnote omitted.]

**AT&T California's Answer:** Paragraph 16 purports to characterize D.07-09-020; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself, but admits that D.07-09-020 did allow a 2.36% basic service rate increase effective January 1, 2008.

17. **TURN's Allegation:** AT&T exercised this option in April 2008, increasing its rates for flat service to \$10.94. Verizon raised its flat rate to \$17.66. [Footnote omitted.]

**AT&T California's Answer:** AT&T California admits that it increased its rates in April 2008 precisely as authorized by the Commission. AT&T California admits the second sentence in this paragraph.

18. **TURN's Allegation:** In D.08-09-042, the Commission ordered a "phased transition" to the pricing freedoms for residential basic services approved in D.06-08-030. Taking a large step toward full price deregulation, the CPUC raised the price caps for the flat services offered by all four ILECs by a significant amount -- \$3.25 per year in each of 2009 and 2010 -- and re-set the date for the removal of all price caps to January 1, 2011.<sup>22</sup>

<sup>22</sup> D.08-09-042, p. 4. The Commission retained some restrictions on basic service rates in areas receiving support from the CHCF-B. In such areas, the ILECs could not increase basic rates above the lower of: (1) 150% of the ILECs' aggregate rate for exchanges not receiving CHCF-B support; or (2) the \$36 high-cost benchmark minus the federal end user common line ("EUCL") charge. D.08-09-042, p. 47. The CPUC re-emphasized its previous statement in D.07-09-020 that the \$36 high-cost benchmark was in no way intended to indicate that the Commission believed it was appropriate for stand-alone basic service to rise to a level of \$36 per line. D.08-09-042, p. 43.

**AT&T California's Answer:** Paragraph 18 and footnote 22 purport to characterize D.08-09-042; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. Answering further, AT&T California admits that in D.08-09-042 the Commission adopted a phased transition, raised price caps for URF ILECs by \$3.25 per year in 2009 and 2010, and removed all price caps effective January 1, 2011. Regarding the last sentence of footnote 22, AT&T California further answers that the Commission also rejected TURN's proposal to extrapolate a basic service benchmark of \$21.19 based on the \$36 threshold for CHFC-B carriers, noting among other things that "TURN does not account for the impact of the frozen basic rates in California" on URF ILECs' rates. *Transition Order*, D.08-09-042 at 44 n.41. TURN's Complaint likewise fails to account for the impact of the previously frozen basic rates in California.

19. **TURN's Allegation:** The Commission based the aggregate \$6.50 increase to the caps for flat service on an analysis of the amount by which AT&T's rates would have increased since they were frozen in 1995 if they had kept pace with the rate of inflation. The analysis used recorded CPI data from 1995 through 2007 and estimated CPI increases of 3.94% each year in 2008, 2009, and 2010.<sup>24</sup>

<sup>24</sup> D.08-09-024, p. 37 and Appendix 1. As will be shown below, these estimates proved to be much higher than the actual inflation rates for 2009 and 2010, in light of the Great Recession.

**AT&T California's Answer:** Paragraph 19 purports to characterize D.08-09-042; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. Answering further, AT&T California notes that the \$6.50 increase applied to AT&T California's rate that had been set in 1995 and that reflected half of AT&T California's regulatory cost of service in 1994. The \$6.50 increase therefore merely adjusted that "half of cost" rate for inflation. It did not purport to create a current market price. Adjusting a "half of cost" rate for inflation still leads to a rate that is artificially low. Indeed, the Commission observed that the 1995 rate was \$8 below the national average basic service rate in 1995 (*Transition Order*, D.08-09-042 at 23-24), and the \$6.50 increase in 2009-2010 did not even make up that difference. With regard to the last sentence of paragraph 24, AT&T California denies that actual inflation rates (or projected inflation rates) are relevant to evaluating an URF ILEC's rates.

20. **TURN's Allegation:** Based on the possibility that AT&T's rates may have previously been capped at "abnormally low" levels compared to the other California ILECs, [Footnote omitted.] the CPUC chose to allow Verizon, SureWest and Frontier to increase their capped flat rates by the same \$6.50 increment as AT&T, resulting in lower percentage increases

than for AT&T. Accordingly, while AT&T's caps increased by 30% and 23% in 2009 and 2010 respectively, the caps for SureWest, the ILEC with the highest basic rates in 2008, increased 17% and 15% in 2009 and 2010. [Footnote omitted.]

**AT&T California's Answer:** Paragraph 20 purports to characterize D.08-09-042; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. While TURN's computations may be correct and Verizon, SureWest, and Frontier were authorized to increase their rates by \$6.50 during 2009-2010, AT&T California's percentage increase was greater only because its then-existing rates had been set lower than those others carriers' rates, so the same dollar increase equated to a larger percentage increase for AT&T California compared to the other ILECs.

21. **TURN's Allegation:** With respect to measured service, D.08-09-042 allowed the rate caps to increase by each ILEC's authorized percentage increase to its flat rate cap. [Footnote omitted.]

**AT&T California's Answer:** Paragraph 21 purports to characterize D.08-09-042; AT&T California states that the Decision speaks for itself and requires no further response.

22. **TURN's Allegation:** The Commission stated that it expected that "normal competitive forces" would narrow the rate disparity between AT&T and the other ILECs, but that since "competitive forces, income levels, and costs" vary by region, some continuing disparities "will be expected and normal." [Footnote omitted.] Thus, while the Commission expected AT&T's basic rates to move closer to those of the ILECs, nothing in D.08-09-042 anticipated that AT&T's rates would quickly leapfrog and pull away from the other ILECs' rates just two years after price caps were removed.



**AT&T California's Answer:** Paragraph 22 purports to characterize D.08-09-042; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. AT&T California denies the second sentence.

23. **TURN's Allegation:** The new flat service rate caps approved in D.08-09-042 were as follows: [Footnote omitted.] [table omitted]

**AT&T California's Answer:** Paragraph 23 purports to characterize D.08-09-042; AT&T California states that the Decision speaks for itself. Answering further, AT&T California notes that in D.08-09-042 the Commission authorized AT&T California and the other URF ILECs to adopt basic residential service rates higher than the highest basic residential service rate of any URF ILEC at the time of the *URF Order*, D.06-08-030. In fact, the *Transition Order* (D.08-09-042 at Appendix 2) authorized Verizon, SureWest and Frontier to adopt basic service rates in 2010 ranging from \$24.16 for Verizon to \$25.40 for SureWest (excluding the EUCL), each of which exceeds AT&T California's basic service residential rate today

24. **TURN's Allegation:** In response to the increased caps, AT&T increased its residential flat rate to \$13.50 in January 2009 and to \$16.45 in January 2010. As anticipated by the Commission, these rate hikes brought its rates much closer to those of the other URF LECs, which, for their part, exercised little of the new pricing flexibility made available to them.

**AT&T California's Answer:** AT&T California admits that it raised its residential flat rate to \$13.50 in January 2009 and to \$16.45 in January 2010, and admits that its rate increases brought its basic service rates closer to the rates of the other URF LECs. Except as admitted, AT&T California denies the allegations of this paragraph.

25. **TURN's Allegation:** As discussed in the next section, after price caps were completely removed on January 1, 2011, AT&T has continued its practice of sharp annual rate

increases for basic services, while SureWest has not raised rates at all, and Frontier and Verizon has implemented only modest rate increases.

**AT&T California's Answer:** AT&T California admits that on or after January 1, 2011, it has increased its rates for basic services, as have Frontier and Verizon, while SureWest has not increased rates for those services. Except as admitted, AT&T California denies the allegations of this paragraph.

26. **TURN's Allegation:** The following facts, taken in combination, show that competition has not imposed sufficient restraint on AT&T's basic service rates to ensure that they remain just and reasonable.

**AT&T California's Answer:** Denied.

27. **TURN's Allegation:** Beginning with the major increases to price caps on January 1, 2009 and continuing to the present, AT&T's basic service rates have skyrocketed. In the space of just four years from January 1, 2009 to January 1, 2013, AT&T has increased its flat rates by 115% and its measured rates by 222%.

**AT&T California's Answer:** Denied. Answering further, AT&T California notes that TURN's computations ignore, among other things, the facts that (i) price increases in 2009 and 2010 were expressly authorized by the Commission as part of a transition to full pricing flexibility and were based on AT&T California's 1995 "half of cost" adjusted rate for inflation; and (ii) the Commission was well aware that prices would likely increase further once full pricing flexibility took effect on January 1, 2011, but made the policy decision to allow such pricing freedom since the market was competitive and no URF ILEC had market power. AT&T California notes that its rate for residential flat-rate basic service is still below the level the Commission authorized for other URF ILECs in the *Transition Order*, D.08-09-042.

28. **TURN's Allegation:** Even if one just focuses on the period after rate caps were completely removed on January 1, 2011, AT&T's rate increases have been steep and regular. On January 1, 2011, AT&T promptly raised its flat service rate from \$16.45 to \$19.95. On January 1, 2012, AT&T increased its flat rate again, to \$21.00. AT&T then tacked on another \$2.00 on January 1, 2013, bringing its rate to \$23.00. Thus, in just two years after the lifting of price caps, AT&T increased its flat service rate by a total of 40%. AT&T's measured rates soared even more quickly, leaping from \$8.87 at the end of 2010, to \$18.35 on 1/1/13, an increase of 107%.

**AT&T California's Answer:** AT&T California admits the allegations of the second, third, and fourth sentences of paragraph 28, except to state that the correct effective dates for the rate changes were January 3, 2011, March 1, 2012, and January 2, 2013. AT&T California denies all remaining allegations of this paragraph, including because it cannot replicate TURN's computations. Answering further, AT&T California states that TURN's figure are meaningless and irrelevant, for they ignore that rate increases began from a base level that was set artificially low due to regulation and that did not reflect (and was not designed to reflect) a competitive market rate. See also AT&T California's response to paragraph 27.

29. **TURN's Allegation:** AT&T's skyrocketing rates following the relaxation and final removal of price caps contrast sharply with the much lower rate hikes imposed by the other three URF LECs since January 1, 2009. SureWest, which used to have the highest basic rates in California, has only increased its flat rate by \$1.09 to \$19.99, a 6% increase. Frontier's flat rate has increased \$1.15 to \$19.00, also a 6% increase. Although Verizon has increased its rates more significantly than SureWest and Verizon, its highest flat rate has increased a relatively modest 25% (compared to AT&T's 115%) to \$22.00.

**AT&T California's Answer:** AT&T California admits the allegations of the second and third sentences of paragraph 29 regarding SureWest's and Frontier's current rates, but cannot replicate TURN's calculations of alleged increases "since January 1, 2009" and therefore denies them. AT&T California also admits that Verizon increased its rate to \$22.00. AT&T California denies all remaining allegations of this paragraph, and further notes that in the *Transition Order* (D.08-09-042 at Appendix 2), SureWest, Verizon, and Frontier had each been authorized to increase their rates to more than \$24 per month in 2010 (ranging from \$24.16 for Verizon to \$25.40 for SureWest), which exceeds AT&T California's current rate.

30. **TURN's Allegation:** With respect to measured service, AT&T's rate increases since the removal of price caps have been astronomical compared to those of the other ILECs. AT&T's 107% measured service rate hikes dwarf the increases imposed by SureWest (8.0%), Frontier (38%), and Verizon (34%).

**AT&T California's Answer:** Denied. Answering further, AT&T California states that TURN's figures are misleading and ignore that rate increases began from a base level that was set artificially low due to regulation and that did not reflect (and was not designed to reflect) a competitive market rate. Computing percentage increases from an artificially low, regulated rate level is meaningless. Under URF it is the market, not regulation, that constrains rates.

31. **TURN's Allegation:** Consequently, as shown in Figures 1 and 2 in Section I of this Complaint, in just two years after the lifting of price caps, AT&T has transformed itself from the ILEC with the lowest basic service rates in California to the carrier with the highest rates. The Commission accurately predicted that the former rate disparity, in which AT&T's regulated rates were much lower than the rates of the other ILECs, would narrow. However, now a new and unpredicted rate disparity has developed: AT&T's basic service rates have significantly

surpassed the rates for SureWest and Frontier, the carriers that used to have the highest basic rates among the four ILECs.

**AT&T California's Answer:** AT&T California admits that its basic service rates were previously held artificially low and below cost at levels lower than the next three largest ILECs, and that those rates are now somewhat higher than the next three largest ILECs. Except as admitted, AT&T California denies the allegations of paragraph 31.

32. **TURN's Allegation:** As previously noted, in D.06-08-030, the Commission explained that it would ensure that basic residential service does not “trend above” the current highest basic residential rate in the state. [Footnote omitted.] At that time, the highest rates for stand-alone residential flat and measured service were SureWest's \$18.90 and \$12.95 rates. AT&T's \$23.00 and \$18.35 rates are soaring, not just trending, above those rates.

**AT&T California's Answer:** The first sentence of paragraph 32 purports to characterize D.06-08-030; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. AT&T California admits the second sentence of paragraph 32, and denies the third sentence. Answering further, AT&T California states that TURN's interpretation of the *URF Order* (D.06-08-030) as intending to keep basic service rates below the highest level as of 2006 is incorrect. When establishing rate caps for the transition period prior to full pricing flexibility, the Commission authorized Verizon, SureWest, and Frontier to adopt rates of more than \$24.00 (ranging from \$24.16 for Verizon to \$25.40 for SureWest), which plainly exceeds the highest rate in 2006. The Commission also was aware that rates could increase once the transition period ended, and one of the purposes of URF is to do away with all rate caps (*Transition Order*, D.08-09-042 at 12, 26).

33. **TURN's Allegation:** AT&T's rates even exceed the CPUC-regulated rates for the smallest carriers that serve the highest cost exchanges in California and receive funding from the CHCF-A ("Small LECs"). These carriers continue to be regulated through a rate of return framework. The Commission reviews the companies' costs and revenues and sets a rate that it determines is just and reasonable to ensure the carriers collect sufficient revenue to earn a reasonable rate of return. Because these carriers are much smaller than the URF LECs and serve so many fewer people, often the amount of revenue that needs to be collected from each customer to compensate these carriers with a reasonable rate of return is much higher than what the Commission determines would be a just and reasonable rate. Therefore, the Commission sets just and reasonable rates and provides subsidy money beyond that rate to ensure the carrier is fully compensated.

**AT&T California's Answer:** Paragraph 33 purports to characterize the Commission's rulings regarding regulation of carriers that receive funding from CHCF-A; AT&T California denies that TURN has completely and correctly characterized those rulings and states that the rulings speak for themselves. AT&T California admits that a \$23.00 rate for flat service is higher than \$20.25, the regulated rate for carriers receiving CHCF-A funding. Answering further, AT&T California states that any discussion of the rates of ILECs that receive CHCF-A support is irrelevant to the rates of an URF ILEC. CHCF-A carriers have regulated, capped rates. By contrast, the Commission has made a deliberate legal and policy decision that URF ILECs should not be subject to rate caps (because they face competition and lack market power). Nor do any of the Commission's decisions say that the rates of CHCF-A ILECs have any bearing on the reasonableness of rates for URF ILECs. The \$20.25 regulated rate of CHCF-A carriers is therefore meaningless in the context of this case.

34. **TURN's Allegation:** Up until recently, the Commission determined that the just and reasonable rate for customers of these smaller carriers should be capped at 150% of AT&T's rate. The Commission has explained that by "[l]imiting the maximum level of Small LEC basic rates in this manner, basic service remained affordable and the availability of universal service for all Californians was protected." [Footnote omitted.]

**AT&T California's Answer:** Paragraph 34 purports to characterize the Commission's rulings regarding regulation of carriers that receive funding from the CHCF-A; AT&T California denies that TURN has completely and correctly characterized those rulings and states that the rulings speak for themselves. See also the answer to paragraph 33.

35. **TURN's Allegation:** In a 2009 application, the Small LECs requested that the Commission "de-link" their basic service rates from AT&T's basic rate because of concern over rate shock. They argued that, in light of the rate increases already imposed by AT&T (and the potential for more at any time), requiring the smaller carriers to raise their rates in lock-step with AT&T's rates in order to receive funding from the CHCF-A would cause rate shock among their customers. While the Commission did not grant the specific request of the Small LECs, it agreed that the current rate design linking the Small LEC rates to AT&T rates had the potential to cause rate shock. The Commission determined that, on an interim basis, pending a review of the CHCF-A, the basic residential flat rate that Small LECs must charge to qualify for CHCF-A support was \$20.25. The Commission stated, "This interim measure will provide reasonable protection against the risk of rate shock to the Small LECs and their customers . . . ."

**AT&T California's Answer:** Paragraph 35 purports to characterize the Commission's rulings regarding regulation of carriers that receive funding from the CHCF-A; AT&T California

denies that TURN has completely and correctly characterized those rulings and states that the rulings speak for themselves.

36.       **TURN's Allegation:** Thus, even in serving areas where the costs to provide service are demonstrably higher than AT&T's costs and the customer base is demonstrably smaller, the Commission has determined that flat service rates should not exceed \$20.25. The Commission reached this determination even though the consequence of capping the rate at \$20.25 is to require all other ratepayers to subsidize the costs of service that are not recovered by that rate.

**AT&T California's Answer:** Paragraph 36 purports to characterize the Commission's rulings regarding regulation of carriers that receive funding from the CHCF-A; AT&T California denies that TURN has completely and correctly characterized those rulings and states that the rulings speak for themselves. Answering further, AT&T California states that any discussion of the rates of ILECs that receive CHCF-A support is irrelevant to the rates of an URF ILEC. CHCF-A carriers have regulated, capped rates. By contrast, the Commission has made a deliberate legal and policy decision that URF ILECs should not be subject to rate caps (because they face competition and lack market power). Nor do any of the Commission's decisions say that the rates of CHCF-A ILECs have any bearing on the reasonableness of rates for URF ILECs. The \$20.25 regulated rate of CHCF-A carriers is therefore meaningless in the context of this case.

37.       **TURN's Allegation:** This \$20.25 cap remains in place today. [Footnote omitted.] AT&T's current flat rate exceeds it by a substantial margin, \$2.75, or 14%.

**AT&T California's Answer:** AT&T California admits that a flat rate of \$23.00 is higher than the \$20.25 cap for carriers receiving CHCF-A funding by \$2.75. AT&T California



denies all remaining allegations of this paragraph and further notes that URF ILECs are not subject to rate caps. See also AT&T California's AT&T California's Answer to paragraph 36.

38. **TURN's Allegation:** As discussed above, in D.08-09-042, the Commission used the rate of inflation since rates were frozen in 1995 as a means of determining appropriate caps for AT&T's basic rates during the transition to full pricing flexibility in 2009 and 2010. A similar analysis shows that AT&T's rate increases since price caps were removed on January 1, 2011 have dramatically outpaced the rate of inflation.

**AT&T California's Answer:** The first sentence of paragraph 38 purports to characterize D.08-09-042; AT&T California denies that TURN has completely and correctly characterized that Decision and states that the Decision speaks for itself. AT&T California denies the allegations of the second sentence of paragraph 38. Answering further, AT&T California states that nothing in any decision, including the *URF Order* (D.06-08-030) and the *Transition Order* (D.08-09-042), ties the appropriate rate for an URF ILEC with pricing flexibility to the rate of inflation. In addition, even if one did apply the rate of inflation to AT&T California's fully allocated costs from 1994, the costs of basic service today would be \$40.89 (see footnote 4 above).

39. **TURN's Allegation:** AT&T's flat rate on December 31, 2010 was \$16.45. This rate resulted from AT&T taking advantage of most of the price cap increases for 2009 and 2010 that the Commission granted in D.08-09-042.<sup>33</sup> AT&T's major rate increases in 2009 and 2010 – from \$10.94 to \$16.45 – significantly narrowed the disparity between AT&T's rate and the rates of the other URF LECs. AT&T's measured rate on December 31, 2010 was \$8.87.

<sup>33</sup> The revised price caps determined in D.08-09-042 allowed AT&T to increase its flat rate to \$17.44 in 2010. However, that price cap was based on a major over-estimate of the rate of inflation for 2009 and 2010. Whereas the Commission estimated inflation of 3.94% for 2009 and 2010 (D.08-09-042, p. 37), the actual rates for those years (owing to the impacts of the Great

Recession) were -0.4% (i.e., deflation) and 1.6%. Applying these actual inflation rates to the \$16.14 inflation-adjusted rate through 2008 of \$16.14 (*id.*), the resulting flat rate cap would have been \$16.33, which is slightly below AT&T's actual 2010 rate of \$16.45. Thus, AT&T's \$16.45 rate approximates the rate that would have resulted if AT&T's rate had kept pace with inflation since 1995.

**AT&T California's Answer:** AT&T California admits the first, second, and last sentences of paragraph 39, admits that its basic rate went from \$10.94 in 2008 and to \$16.45 in 2010, and denies the remaining allegations of this paragraph. AT&T California admits the first sentence of footnote 33, but further notes that its rate increases in 2009 and 2010 were fully authorized by the Commission in the *Transition Order* (D.08-09-042) and were designed only for the transition to full pricing flexibility; they were not designed to bring AT&T California's rates up to competitive market levels or to establish any kind of rate cap after December 31, 2010. Rather, the Commission fully expected that rates could increase once URF carriers were given full pricing flexibility. Regarding the second through fifth sentences of footnote 33, AT&T California admits that the CPI-U figures summarized by TURN appear to track the data sources cited by TURN, but denies that such figures are relevant here, and further answers that rate cap authorized by the Commission for 2010 merely reflected an inflation adjustment to rates based on half of AT&T California's regulatory cost of service in 1994, and therefore still reflected a significantly outdated, abnormally low rate.

40. **TURN's Allegation:** The annual percentage changes in the CPI-U<sup>34</sup> from 2008 through 2012 are shown in the following table: [table omitted]

<sup>34</sup> As previously noted, the Commission used the CPI-U as the measure of inflation in D.07-09-018. It appears that CPI-U was also used in D.08-09-042, but this is not made explicit in the decision.

**AT&T California's Answer:** AT&T California admits that the CPI-U figures summarized by TURN appear to track the data sources cited by TURN, but states that the rate of

inflation is irrelevant, particularly when measured against a beginning regulated rate level that was set artificially low, and that none of the Commission's URF decisions refer to the rate of inflation as a relevant measure for the rates of an URF ILEC with full pricing flexibility.

Regarding footnote 34, AT&T California further answers that the Commission did not conclude that the CPI-U, or any measure of inflation, is an appropriate benchmark for rates after the transition period, when URF carriers were granted "full pricing flexibility" to increase rates from the abnormally low levels that had been imposed from 1995-2008 and during the transition period in 2009-2010.

41. **TURN's Allegation:** Beginning January 1, 2011, if AT&T increased its rates by the CPI increase from the previous year, its rates would have increased by 1.6% in January 2011, 3.2% in January 2012, and 2.1% in January 2013, resulting in a January 2013 flat rate of \$17.61 [Footnote omitted.] and a measured rate of \$9.50. [Footnote omitted.] The differences between AT&T's inflation adjusted rates and actual rates on January 1, 2013 are summarized in the following table: [table omitted]

**AT&T California's Answer:** AT&T California has not been able to replicate TURN's calculations, and on that basis denies the allegations of this paragraph. In addition, as of January 1, 2013, AT&T California's measured rate was \$18.25, not \$18.35. Answering further, AT&T California states that the rate of inflation is irrelevant, particularly when measured against a beginning regulated rate level that was set artificially low. See also the answer to paragraph 40.

42. **TURN's Allegation:** Thus, AT&T's current flat rate exceeds its inflation-adjusted rate by more than 30%, and its current measured rate exceeds the inflation-adjusted rate by more than 90%.

**AT&T California's Answer:** AT&T California has not been able to replicate TURN's calculations, and on that basis denies the allegations of this paragraph. See also AT&T California's Answers to paragraphs 40 and 41.

43. **TURN's Allegation:** Going back to the initial relaxation of price caps on January 1, 2009, the disparity between AT&T's basic rate increases and inflation is even more stark. As noted in Section I, AT&T's 115% and 222% increases to flat and measured rates in that period of time compare to aggregate inflation of only 7%.

**AT&T California's Answer:** AT&T California has not been able to replicate TURN's calculations, and on that basis denies the allegations of this paragraph. See also AT&T California's Answers to paragraphs 40 and 41.

44. **TURN's Allegation:** The Commission has long recognized that, AT&T's average costs to provide basic service are the lowest of the four URF LECs. This results primarily from the fact that AT&T serves the most densely populated urban areas in the state, including the cities in the San Francisco Bay Area (including San Francisco, Oakland, and San Jose), Los Angeles and most surrounding cities, San Diego, and Sacramento. [Footnote omitted.] In D.06-08-030, in support of its decision to allow deaveraging of basic rates, the Commission reiterated the well-accepted fact that high traffic and population densities in urban areas cause costs to be low. [Footnote omitted.] Furthermore, as the largest carrier in California, AT&T benefits from economies of scale and scope that give it a further cost advantage, particularly compared to the much smaller ILECs, Frontier and SureWest.

**AT&T California's Answer:** AT&T California admits that it is the largest ILEC in California, that it serves some of the most densely populated urban areas in the State (including in the San Francisco Bay Area, the Los Angeles area, San Diego, and Sacramento), and that with

respect to some aspects of its operations it may benefit from economies of scale and scope compared to smaller ILECs. The remainder of this paragraph purports to characterize the Commission's findings. AT&T California denies that TURN has completely and correctly characterized the Commission's findings and states that those findings speak for themselves. Answering further, AT&T California notes that the Commission did away with cost-of-service regulation for telecommunications in the late 1980s and expressly declined in to rely on cost-of-service analysis. *Transition Order*, D.08-09-042 at 7, 22 ("There simply is no basis in the record to consider that price regulation based on cost studies is necessary to ensure that prices are just and reasonable."). Rather, the Commission, in accord with federal and state policy, elected to rely on the competitive market to set rates. *Id.* at 5-6, 22-25. This renders any comparison of alleged costs of service meaningless and irrelevant for an URF ILEC.

45. **TURN's Allegation:** The Commission's regulations have consistently treated AT&T as the lowest-cost incumbent carrier in California. When the Commission set rates based directly on costs, AT&T's basic service and other rates were always the lowest. As the Commission noted in the *URF Transition Order*, D.08-09-042, the residential basic service rates that were in effect when ILEC rates were frozen in the mid-1990s were set to recover one-half of each ILECs' total costs. [Footnote omitted.] At that time, AT&T's flat rate of \$11.25 was \$6.00 less than the corresponding rate of the carrier with the next-lowest costs, Verizon, a clear demonstration that AT&T's costs were significantly lower than all other ILECs.

**AT&T California's Answer:** Paragraph 45 purports to characterize the Commission's regulations and findings. AT&T California denies that TURN has completely and correctly characterized the Commission's regulations and findings, and states that those regulations and findings speak for themselves. AT&T California admits that in the mid-1990s, its basic flat rate

of \$11.25 was set to recover only one-half of AT&T California's fully allocated costs, and that the rate was more than \$6.00 below the rate of the ILEC with the next lowest rate, Verizon. See also AT&T California's AT&T California's Answer to paragraph 44.

46. **TURN's Allegation:** Moreover, when the Commission was required to determine cost-based rates for the loop unbundled network element ("UNE"), the Commission set AT&T's loop rates at levels much lower than the other URF LECs. The Commission-established UNE loop rates (geographically averaged) for AT&T varied between \$9.93[Footnote omitted.] and \$11.93. [Footnote omitted.] The geographically averaged UNE loop prices determined for Verizon, the company with the next lowest average costs, were much higher, ranging from \$13.94[Footnote omitted.] to \$16.81. [Footnote omitted.]

**AT&T California's Answer:** AT&T California admits that the average UNE loop rates listed in paragraph 46 have been correctly listed. To the extent that paragraph 46 purports to characterize the Commission's UNE loop rate decisions, AT&T California denies that TURN has completely and correctly characterized those decisions and states that the decisions speak for themselves. See also AT&T California's AT&T California's Answer to paragraph 44.

47. **TURN's Allegation:** In sum, AT&T has the lowest average costs to provide basic service of any of the URF LECs. Even though the Commission expected competition to constrain AT&T's rates for stand-alone basic services, AT&T's steep basic rate increases in the past several years run directly counter to this expectation. AT&T's current rates compare extremely unfavorably with the rates of Frontier and SureWest -- AT&T's current flat and measured rates exceed those of SureWest by 15.1% and 31.2% respectively and exceed Frontier's flat and measured rates by 21.1% and 38.5% respectively -- even though the

Commission has long recognized SureWest and Frontier to have much higher costs to provide basic service than AT&T.

**AT&T California's Answer:** AT&T California lacks sufficient information or belief to admit or deny how its costs would compare with those of other carriers, and therefore denies the allegations of this paragraph. Answering further, AT&T California states that the Commission has recognized that many different factors drive rates in a competitive market. *Transition Order*, D.08-09-042 at 35, 44 (“Competitive forces, income levels and costs vary by region, and thus, some disparities will be expected and normal”; “Actual adjustments in the basic rate will be a function of competitive influences, marketing strategies of the ILEC, as well as actual changes in costs and technologies over time.”) See also AT&T California's AT&T California's Answer to paragraph 44, explaining that alleged costs of service are not relevant to evaluating the rates of URF ILECs, which have full pricing flexibility.

48. **TURN's Allegation:** AT&T's sharp increases in basic service rates have been accompanied by dramatic increases in other rates and charges for residential customers. The pattern of across-the-board increases for AT&T residential services is demonstrated by the Summary of URF ILEC Residential Service Rate Changes, prepared by the CPUC's Communications Division (“CD”) in February 2013 and attached to this Complaint as Attachment B. Notable among the sharp rate hikes for the listed services are: AT&T's current local toll rates of 30 cents per minute, as compared to rates less than 10 cents per minute in 2006; and the steep rate increases since 2006 – between 62% and 295% -- for individual custom calling services. In addition, from 2006 to the present, AT&T has sharply increased other charges that many residential customers may choose or encounter, such as: the WirePro inside wire repair plan (from \$2.99 to \$8.00 per month); late payment charges (from no fixed charge, 1.5% of the

unpaid balance in 2006, to a \$2.50 fixed charge, 2.0% of unpaid balance); and returned check charges (from \$6.65 to \$25.00). For most, if not all, of the residential services listed in Attachment B, AT&T has the highest rates of all the URF ILECs.

**AT&T California's Answer:** AT&T California was not served any "Attachment B" to the Complaint. AT&T California admits that since 2006 it has increased certain rates for certain AT&T California residential services, including those specifically identified in paragraph 48. AT&T California denies all remaining allegations in this paragraph, and adds that rates for other services are irrelevant to any analysis of AT&T California's basic service rates.

49. **TURN's Allegation:** In short, AT&T's unjust and unreasonable basic service rates are part of a pattern of steep rate increases for other services for which competition is failing to restrain AT&T's prices.

**AT&T California's Answer:** Denied. Answering further, TURN's contention that AT&T California's price increases for other non-basic services have any bearing on the reasonableness of basic service rates is irrelevant. Nothing in the Commission's decisions made pricing flexibility contingent on rates charged for non-basic services. Comparisons to unrelated rates are meaningless.

50. **TURN's Allegation:** The Commission has previously explained that the reasonableness of a basic service rate increase depends in part on whether the increase is accompanied by offsetting rate reductions for other services, thus mitigating any increase in the customer's total bill. In D.08-09-042, the Commission rejected the proposal of AT&T to increase its price caps by \$6.05 per year, noting reductions in the CHCF-B surcharge would not offset an increase as large as \$6.05. The Commission also determined that more modest increases to basic service were warranted because, after D.06-08-030 deregulated the rates for non-basic services,



AT&T had increased rates for such services. [Footnote omitted.] Here, AT&T's post-deregulation rate hikes for basic services have not been tempered by any rate reductions for other residential services. Based on the logic of D.08-09-042, the fact that AT&T's non-basic service rates have also increased astronomically only accentuates the unreasonableness of AT&T's steep basic service rate increases following the removal of price caps.

**AT&T California's Answer:** The first three sentences of paragraph 50 purport to characterize the Commission's findings and conclusions in prior cases. AT&T California denies that TURN has completely and correctly characterized those findings and conclusions, and states that the Commission's findings and conclusions speak for themselves. AT&T California denies the last two sentences of paragraph 50. Answering further, AT&T California states that rates for other services are not relevant to evaluating AT&T California's basic service rates. Every AT&T California rate increase for basic exchange rates beginning in 2009 had been fully authorized by the Commission in its decisions and fully consistent with the pricing policy reflected in those decisions. Nothing limits AT&T California's pricing flexibility by conditioning its right to increase rates for basic service on reducing rates for other services.

51. **TURN's Allegation:** All of the facts presented above, in combination, demonstrate that AT&T's basic service rates are no longer just and reasonable. As the largest ILEC serving most urban areas in California and therefore enjoying the lowest average costs to serve, AT&T has historically offered the lowest basic service rates in the state. Although the Commission has posited that AT&T's pre-2008 regulated rates may have been "abnormally low," no Commission decision anticipated that, once the price caps for URF ILEC basic service rates were removed, AT&T's basic service rates would skyrocket to the highest levels in the state. Nor did any Commission decision anticipate that, after AT&T took advantage of the

increases to the price caps in 2009 and 2010 permitted by D.08-09-042 and significantly narrowed the disparity between its basic rates and those of the other ILECs, AT&T would continue to raise its prices for basic service at a pace that dwarfed the rate of inflation. In just two years when inflation added only 5% to general price levels, AT&T hiked its flat service rate by 40% and its measured service rate by 73%. The only reasonable explanation for such brazen rate increases is that AT&T is exploiting the pricing freedom afforded by the Commission, and that competition is not restraining AT&T's basic service rates.

**AT&T California's Answer:** AT&T California denies the first and last sentences of paragraph 51. AT&T California admits that it is the largest ILEC in California and serves many of the largest urban areas in the State. AT&T California has not been able to replicate TURN's calculations, and on that basis denies the allegations of the fifth sentence of this paragraph. The remainder of the paragraph purports to characterize the Commission's decisions; AT&T California denies that TURN has completely and correctly characterized those decisions and states that the decisions speak for themselves. Answering further, AT&T California states that the Commission fully anticipated rate increases once full pricing flexibility took effect for URF ILECs, yet, contrary to TURN's allegations, did not in any way restrict those price increases based on comparisons to the rates of other carriers, to the alleged underlying costs of service, to the rate of inflation, or to reductions in rates for other services. Rather, the Commission relied on competition alone to discipline prices, and nothing in TURN's Complaint shows that AT&T California has been able to sustain prices above competitive levels.

52. **TURN's Allegation:** Although subscription to wireline voice service has fallen, it still remains a vital service for a significant percentage of California households. In a 2011 CPUC CD staff report ("2011 CD Report"), CD noted the then-available data that 24% of

California's households relied solely upon traditional landline telephone service. [Footnote omitted.] In the words of CD, traditional landline voice service "remains an important service." [Footnote omitted.] In addition, 2011 data from the federal government shows that over half of California households regularly use landline service, either solely or in combination with wireless service.<sup>48</sup>

<sup>48</sup> Centers for Disease Control and Prevention, U.S. Dept. of Health and Human Services, "Wireless Substitution: State-level Estimates From the National Health Interview Survey, 2010-2011", Table 2, p. 7 (California data for "dual-use", "landline mostly", and "landline only" adult households).

**AT&T California's Answer:** AT&T California admits that the CD's Market Share Analysis of data through 2009 found that 24% of California households rely solely on traditional wireline phone service for voice communications. Regarding the last sentence of the paragraph, AT&T California admits that the federal government survey cited by TURN estimated in 2011 that 50.5% of California households fell within the categories cited. AT&T California further notes that the same federal government survey (at Table 2 page 7) indicated that only 7.8% of adults in California rely on landline service alone. AT&T California admits that subscription to traditional wireline voice services has been declining. AT&T California denies all remaining allegations of this paragraph.

53. **TURN's Allegation:** Moreover, a significant share of households subscribes to both wireless service and traditional wireline service. The 2011 CD report found that, as of December 2009 (the most recent data available to TURN), 16.8 million households still receive traditional wireline service. [Footnote omitted.]

**AT&T California's Answer:** AT&T California admits that there are households that subscribe to both wireless service and traditional wireline service, and that the 2011 CD report

found that, as of December 2009, 16.8 million households still receive traditional wireline service. AT&T California denies all remaining allegations of this paragraph.

54. **TURN's Allegation:** It should not be surprising that, despite the mobility benefits of wireless service, subscription to traditional wireline service remains so high. The Commission has recently found that, “the principles of universal service extend to all segments of the public, not just the technologically sophisticated whose calling needs may be met by wireless or other alternative technologies” and that “more vulnerable sectors of the public are not prepared or equipped to forfeit current protections offered through wireline basic service.” [Footnote omitted.] The affordability of wireline basic service remains of critical importance because, as the Commission also found, “wireline and wireless services may be complementary rather than complete substitutes for each other.” Traditional wireline service offers advantages over wireless and VOIP services that many households consider important. And, “most customers still value features currently available through wireline basic service that may not otherwise be available through a current wireless service plan.” For example, call quality for wireless services, including ability to engage in “cross-talk,” is generally inferior to wireline service. For many households, wireless signal strength is inadequate to provide service inside or near their homes. Wireless service is of limited use during a lengthy power outage, as the service no longer works once a phone has lost its battery power. In contrast, traditional landline phone service has its own separate power supply that is generally unaffected by power outages. Portable wireless phones are of no use in an at-home emergency when the wireless phone users have left the home premises.

**AT&T California's Answer:** To the extent paragraph 54 purports to characterize prior Commission findings, AT&T California denies that TURN has completely and accurately

characterized those findings, and states that the Commission's findings speak for themselves.

To the extent paragraph 54 purports to contrast the relative benefits of wireless and wireline and VoIP services, AT&T California admits that each service may have various advantages and disadvantages. To the extent this paragraph quotes from Commission decisions, those decisions speak for themselves and the allegations require no response, but AT&T California denies that TURN has fully and accurately characterized those decisions. AT&T California further notes that according to the 2011 CD report cited by TURN, the number of "wireless-only" households in California *exceeds* the number of "wireline-only" households.

55. **TURN's Allegation:** VOIP services also have limitations that render them inferior to traditional wireline service. VOIP services such as Vonage that operate on top of a separately provided broadband service will not allow outgoing calls when the broadband service is not operating, such as during a power outage. Cable VOIP services offer limited backup power, but will cease operating if power is out longer than a few hours.

**AT&T California's Answer:** To the extent paragraph 55 purports to contrast the relative benefits of VOIP and traditional wireline services, AT&T California admits that each service may have various advantages and disadvantages, and denies that VOIP services are inferior to traditional wireline service. AT&T California lacks sufficient information or belief to admit or deny the second and third sentences of this paragraph, and on that basis denies them.

56. **TURN's Allegation:** The Commission requires that carriers offering voice services through alternative technologies provide 911/E911 services "reasonably comparable" to wireline basic service. [Footnote omitted.] In order to qualify as a Carrier of Last Resort, providers of alternative technologies have the burden to demonstrate that they can provide adequate emergency calling capability, suggesting that this Commission recognizes the critical

importance of robust and effective emergency calling. To date, no wireless or VoIP carrier has attempted to make this showing and it is uncertain whether these alternative technologies are up to the task.<sup>52</sup> This means the Commission must be cognizant of the reliance on wireline technology for sufficient emergency calling, particularly by vulnerable populations such as the elderly and disabled.

<sup>52</sup> In fact, the Commission concluded that it did not have a sufficient record to conclude that alternative technology providers such as wireless and VOIP are capable of meeting service quality standards necessary to carry out the statutory obligation to provide universal service to “interact and participate in modern society” and that competitive forces are not sufficient to ensure wireless carriers will be motivated to meet sufficient service quality standards. D.12-12-038, p. 45.

**AT&T California’s Answer:** The first two sentences of paragraph 56 and footnote 52 purport to characterize the Commission’s orders and regulations; AT&T California denies that TURN has completely and accurately characterized those orders and regulations, and states that the Commission’s orders and regulations speak for themselves. AT&T California lacks sufficient information or belief to admit or deny the third sentence of paragraph 56, and on that basis denies it. The last sentence of paragraph 56 does not appear to allege any fact, but appears to be a statement of TURN’s position as a matter of policy, and as such no answer is required.

57. **TURN’s Allegation:** For these and other reasons, for a large number of households, traditional wireline service remains essential for their ability to reliably and effectively communicate with others, including in emergency situations.

**AT&T California’s Answer:** TURN’s allegation in this paragraph is merely a statement of TURN’s opinion to which no response is required.

58. **TURN’s Allegation:** It has been seven years since the Commission found in D.06-08-030 that competition could be relied upon to ensure just and reasonable rates for voice communications services in California. As has been shown, since that deregulation decision,

AT&T's basic rates have leapfrogged those of the other ILECs, and AT&T's steep rate increases show no signs of abating.

**AT&T California's Answer:** AT&T California admits the first sentence of paragraph 58. AT&T California denies the second sentence of paragraph 58.

59. **TURN's Allegation:** Almost three years ago, the Assigned Commissioner (Commissioner Bohn) in R.09-06-019 issued a Ruling and Amended Scoping Memo ordering a new phase in that proceeding to re-examine whether competition was sufficient to produce just and reasonable rates, including for basic services. The Ruling made a compelling case for such a reexamination:

*Examining the level of competition in the telecommunications industry is critical in the Commission's discharging of its duty to ensure the telecommunications service prices remain just and reasonable. Many of the policies adopted in the telecommunications arena since 2005 are premised on the assumption that sufficient competition exists to keep the prices of telecommunications services in check. It is reasonable that we inquire as to whether competition within the industry is robust enough to maintain just and reasonable pricing.*

Moreover, since the issuance of the URF Decision, the Commission has received several reports and Petitions for Modification concerning the policies we adopted in URF, notable the [California] Senate Report, TURN's Report, the DRA Report, the DRA's 2008, and 2010 Petitions for Modification and CD's Report, discussed above. The Commission has not formally considered the merits of any of these reports and filings. We believe that this expanded scope of the rulemaking provides the appropriate forum in which to consider the arguments of and/or data presented by the Senate Office of Oversight and Outcomes Report, TURN, DRA and CD.

URF and several other Commission decisions are premised on the assumption that vigorous competition governs pricing practices in the telecommunications marketplace. We continue to believe that this assumption has merit. However, *it has been over four years since this Commission issued the URF Decision, and it is appropriate that the Commission inquire as to whether changes in the marketplace provide any reason to revisit our prior reliance on competition as providing effective price discipline. In particular, we will examine whether the prices of basic service and certain commonly used stand-alone ancillary services have been kept in check by URF.* These issues will be considered in this phase of the proceeding. [Footnote omitted.]

**AT&T California's Answer:** AT&T California admits that TURN quotes from a portion of the Ruling and Amended Scoping Memo in R.09-06-019. TURN's assertion that the Ruling "made a compelling case for such a reexamination" is merely a statement of TURN's opinion to which no response is required.

60. **TURN's Allegation:** On January 20, 2011, shortly after assuming the Assigned Commissioner's role in R.09-06-019, President Peevey issued a new Ruling "temporarily" deferring the schedule for comments that had been established in Commissioner Bohn's Competition Review Ruling. The Ruling stated that President Peevey supported a review of whether competition is sufficient to control prices for the four largest telephone companies in the state. President Peevey's Ruling further stated that, in February or March of 2011, he intended either to issue a new ruling setting a new schedule for a competition review or to present an Order Instituting Rulemaking for the full Commission's consideration for this purpose. [Footnote omitted.] Almost three years have passed since President Peevey's Ruling and the Commission still has done neither.

**AT&T California's Answer:** To the extent paragraph 60 purports to characterize a ruling of President Peevey, AT&T California denies that TURN has fully and accurately characterized that ruling, and states that the ruling speaks for itself. AT&T California admits that, since January 20, 2011, the Commission has not issued a new schedule or OIR regarding a competition review.

61. **TURN's Allegation:** The reasons for a competition review identified by Commissioners Bohn and Peevey have only strengthened in the intervening years. The 2011 CD Report presented a new market share analysis of retail communications in California for the period 2001 through 2009, which showed that, compared to other communications technologies,



market share concentration in California is greatest by far for wireline voice service. [Footnote omitted.] Of perhaps even greater import, whereas the 2001 through 2005 data that was available when the Commission developed the record for D.06-08-030 showed a steady decline in concentration for wireline voice service, the SBC/AT&T and Verizon/MCI WorldCom mergers – which removed the legacy AT&T and MCI WorldCom as key UNE-based competitive threats for wireline voice service in late 2005 and early 2006 – broke the declining trend and caused concentration to increase. Since mid-2006, unlike the 2001-2005 period, market share concentration for wireline voice service has not declined but has held steady, and perhaps increased as potential market entrants have abandoned business plans to offer residential service in California.<sup>56</sup> Thus, one of the key assumptions of D.06-08-030, that UNE-based competition would continue to impose a competitive check on ILEC pricing, [Footnote omitted.] is dubious at best; at a minimum, this assumption bears careful re-examination in a new competition review.

<sup>56</sup> Even as early as 2009, it was abundantly apparent that the competitive local exchange carrier “threat” to the incumbent market for residential local exchange service was evaporating due to a number of legal and economic developments. *See*, Roycroft, “Why ‘Competition’ is Failing to Protect Consumers, The Limits of Choice in California’s Residential Telecommunications Market.” (March 25, 2009, Prepared on behalf of TURN), pp.5-9.

**AT&T California’s Answer:** AT&T California admits that the 2011 CD Report presented a market share analysis of retail communications in California, and states that that report speaks for itself. AT&T California denies the remaining allegations of this paragraph as well as footnote 56.

62. **TURN’s Allegation:** Of course, as detailed in this Complaint, the most important, and unanticipated, changes in the voice market since late 2010/early 2011 relate to AT&T’s pricing of basic services: (1) even after significantly narrowing the disparity between its rates and those of other ILECs, AT&T has been able to continue to increase raise its basic

service rates at a pace that significantly exceeds the rate of inflation; and (2) even though it enjoys the lowest cost to serve, it now has the highest basic service rates of all the state's ILECs.

**AT&T California's Answer:** AT&T California admits that its basic service rates are currently the highest of the four largest ILECs in the State. Except as admitted, AT&T California denies the allegations of this paragraph, including because it lacks information or belief sufficient to admit or deny the allegations regarding cost of service.

63. **TURN's Allegation:** Clearly, competition is not constraining AT&T's basic service rates. A comprehensive review of competition for voice communication services is necessary to see why this failure has occurred and what long-term reforms are necessary to ensure just and reasonable rates.

**AT&T California's Answer:** Denied.

64. **TURN's Allegation:** This review will also allow the Commission to determine whether AT&T or any other ILEC that holds a state video franchise under the Digital Infrastructure and Video Competition Act of 2006 ("DIVCA"), Sections 5800 *et seq.*, is engaging in the prohibited behavior of using increases to basic service rates to cross-subsidize video services. Section 5940 mandates that state video franchise holders providing "*stand-alone, residential, primary line, basic telephone service shall not increase this rate to finance the cost of deploying a network to provide video service.*" (Emphasis added.). In D.07-09-020, the Commission stated that, based on its previous finding in D.07-03-014 that "[i]t will be relatively easy to review any changes to rates of stand-alone, residential, primary line basic telephone service, either prospectively or retrospectively, to ensure that the increase is not used to finance video deployment," there was no need for "additional reporting requirements or other safeguards to guard against cross-subsidization of video services as prohibited under § 5940." [Footnote

omitted.] AT&T's skyrocketing rates for stand-alone basic service cry out for a Commission examination of whether the increases are being used to subsidize its video offerings. Under the reasoning of D.07-09-020, this analysis should be "relatively easy."

**AT&T California's Answer:** To the extent that paragraph 64 quotes provisions of law and Commission decisions, AT&T California denies that TURN has fully quoted those provisions, and states that they speak for themselves. AT&T California denies that TURN has alleged any facts that, if true, would warrant the investigation suggested in paragraph 64, and denies that TURN is entitled to the relief requested in this paragraph.

65. **TURN's Allegation:** The Commission cannot allow the status quo to continue while it deliberates regarding the opening of the long-promised and long overdue competition review. AT&T's unjust and unreasonable basic service rates are punishing the many millions of California households that subscribe to basic service from AT&T. Upon a finding in response to this Complaint, AT&T's rates should be reduced to just and reasonable levels and should be capped at those levels until the Commission determines in the competition review why competition is not keeping AT&T's rates in check and what regulatory changes are needed.

**AT&T California's Answer:** Denied. The ultimate goal of TURN's Complaint seems to be to have the Commission undertake a general review of competition. AT&T California does not object to such an industry-wide review if the Commission believes it is necessary and elects to devote resources to it. But there is no legal or factual basis for TURN's request here to undo URF and impose rate caps on AT&T California pending such a review. AT&T California's rates have complied with URF every step of the way and continue to be constrained by competition, exactly as the Commission intended when it adopted URF.

66. **TURN's Allegation:** Pending the conclusion of this competition review, the appropriate interim levels for AT&T's basic service rates should be set by reference to the rates of the two smallest URF ILECs, Roseville and Frontier, over which AT&T enjoys (on average) a significant cost advantage. In light of this cost advantage, just and reasonable basic service rates for AT&T should be somewhat lower than the rates of those two carriers; *at a minimum*, AT&T's rates should be no higher. Accordingly, although a strong case could be made for even lower rates, upon a finding that AT&T's rates are not just and reasonable in this docket and during the pendency of the competition review, the Commission should reduce AT&T's basic service rates to no more than \$20 for flat service and \$14 for measured service. These are the current rates for SureWest, which compared to Frontier, has higher basic service rates. The reasonableness of a \$20 flat service rates is reinforced by the fact that it is virtually identical to the current \$20.25 Commission-regulated rate for Small LECs received A Fund support.

**AT&T California's Answer:** Denied. Answering further, AT&T California states that the Commission fully anticipated rate increases once full pricing flexibility took effect for URF ILECs, yet, contrary to TURN's allegations, did not in any way restrict those price increases based on comparisons to the rates of other carriers, to the alleged underlying costs of service, to the rate of inflation, or to reductions in rates for other services. Rather, the Commission relied on competition alone to discipline prices, and nothing in TURN's Complaint shows that AT&T California has been able sustain prices above competitive levels. See also the answer to paragraph 65.

67. **TURN's Allegation:** In deference to the rule against retroactive ratemaking, these rate reductions should be prospective. In conjunction with this Complaint, TURN is filing a Motion for the Establishment of a Memorandum Account for AT&T's Basic Services ("Motion").

The rate reduction should be prospective from the date that the memorandum account established in response to TURN's Motion becomes effective and customers should be provided refunds for the excess amount paid in basic service rates from the date that the memorandum account is established to the date the rate reductions are implemented.

**AT&T California's Answer:** AT&T California agrees that, in accordance with the rule against retroactive ratemaking, any rate reductions must be prospective. AT&T California denies that TURN is entitled to establishment of a "memorandum account" or that such a device could be properly used here to avoid the rule against retroactive ratemaking.

68. **TURN's Allegation:** In accordance with Commission Rule of Practice and Procedure 4.2, TURN provides the following information.

**AT&T California's Answer:** AT&T California admits that TURN purports to provide the following information in accordance with Rule 4.2.

69. **TURN's Allegation:** Complainant TURN is a 501(c)(3) consumer advocacy organization that represents residential and small business consumers in proceedings before the California Public Utilities Commission and other state and federal fora. TURN is a frequent intervenor on issues relating to telecommunications matters before the CPUC and was an active participant in the Commission's dockets that led to the various deregulatory decisions discussed in this Complaint.

The full name, address, telephone and fax number for complainant are as follows:

The Utility Reform Network (TURN)  
785 Market Street, Suite 1400  
San Francisco, CA 94103  
Telephone: (415) 929-8876  
Fax: (415) 929-1132

TURN's attorneys in this case, and their contact information (mailing addresses are the same as above), are as follows:

Christine Mailloux, Staff Attorney  
[E-mail: cmailloux@turn.org](mailto:cmailloux@turn.org)  
Phone: (415) 929-8876

Thomas Long, Legal Director  
[E-mail: tlong@turn.org](mailto:tlong@turn.org)  
Phone: (415) 929-8876 x303

**AT&T California's Answer:** Admitted.

70. **TURN's Allegation:** Pacific Bell Telephone Company d/b/a AT&T California (AT&T) is a corporation organized under the laws of the state of California with principal offices located at 525 Market Street, San Francisco, CA 94105. AT&T is the legal entity that provides regulated telecommunications services in California. AT&T is an incumbent local exchange carrier that serves as a carrier of last resort throughout its service territory in California. AT&T is the largest local service provider in the state. AT&T is the entity that holds Certificate of Public Convenience and Necessity U-1001-C issued by the Commission and it has a tariff on file with the Commission for the provision of residential local exchange service. [Footnote omitted.]

On information and belief, TURN believes that the proper contact information for AT&T is:

Pacific Bell Telephone Company d/b/a/ AT&T California  
Attn: David Tate, Associate General Counsel  
525 Market Street, Room 1904  
San Francisco, CA 94105  
[jon.david.tate@att.com](mailto:jon.david.tate@att.com)

**AT&T California's Answer:** Admitted, except AT&T California denies that it has a CPCN<sup>9</sup> and states that the proper contact information for AT&T California in this proceeding is:

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<sup>9</sup> AT&T California does not hold a Certificate of Public Convenience and Necessity. Rather, Pacific Telephone and Telegraph Company (now named Pacific Bell Telephone Company) received its franchise to operate pursuant to Section 536 of the Civil Code (which now appears as Section 7901 of the Public Utilities Code), prior to the requirement for a CPCN.

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71. **TURN's Allegation:** The issues to be considered in this Complaint proceeding are:

- (1) Whether AT&T's steep increases to its stand-alone basic service rates (flat and measured rate services) following the Commission's removal of price caps for those services on January 1, 2011 are just and reasonable, as required by Public Utilities Code Section 451;
- (2) How soon can the Commission initiate the long-deferred comprehensive review of competition for voice communications services, as promised over two years ago by the former and present Assigned Commissioners in R.09-06-019;
- (3) Whether, pending the outcome of the above-referenced competition review, AT&T's basic service rates should be: (a) reduced and capped, on a prospective basis, to \$20 for flat service and \$14 for measured service, *i.e.*, the levels of SureWest, a much smaller ILEC with higher average costs than AT&T; and
- (4) Whether, in response to the accompanying Motion for the Establishment of a Memorandum Account for AT&T's Basic Services, the Commission should require AT&T to establish a memorandum account for the purposes of allowing rate refunds associated with reduced AT&T basic service rates to customers from the date of the decision ordering the memorandum account to the time of the rate reduction.

**AT&T California's Answer:** AT&T California denies that these are appropriate issues to be considered in this Complaint proceeding, and denies that TURN is entitled to the relief requested therein. Among other things, TURN's complaint fails to state any claim against AT&T California and fails to specifically state any facts that, if true, would demonstrate that any of AT&T California's rates are not just and reasonable.

72. **TURN's Allegation:** The proposed categorization is ratesetting. Pursuant to Section 1701.1(c)(2), complaints as to the reasonableness of rates are an exception to the general rule that complaints are to be classified as adjudicatory cases.

**AT&T California's Answer:** AT&T California agrees that ratesetting is the appropriate categorization of the proceeding pursuant to Section 1701.1(c)(2).

73. **TURN's Allegation:** TURN does not believe there should be any material factual disputes regarding the facts presented in this Complaint showing that AT&T's rates are unjust and unreasonable. Accordingly, at this time, TURN does not see a need for evidentiary hearings. However, if the Commission should determine based on the AT&T California's Answer of the defendants that there are material factual issues in dispute, TURN reserves the right to request evidentiary hearings.

**AT&T California's Answer:** AT&T California contends that TURN's complaint should be dismissed for failure to state a claim, and as a result agrees that there is no need for evidentiary hearings. In the event TURN's complaint is not dismissed, AT&T California reserves the right to request evidentiary hearings.

74. **TURN's Allegation:** Based on TURN's current belief that there are no material factual disputes regarding the issues raised by this Complaint, TURN proposes the following schedule:

Complaint and Motion to Establish a Memorandum Account	December 6, 2013
Complaint Served on Defendants	(Filing of Complaint + 7 days)
Defendants' Response to Motion Filed	(Motion + 15 days)
Complainants' Reply to Response re Motion Filed (if permission granted by ALJ)	(Motion + 25 days)



AT&T California's Answer Filed	(Service of Complaint + 30 days)
Draft Decision Regarding Motion Issued	(Motion + 45 days)
Prehearing Conference	(AT&T California's Answer +15 days)
Concurrent Opening Briefs	(PHC + 30 days)
Concurrent Reply Briefs	(PHC + 50 days)
Draft Decision Regarding Complaint Issued	(Reply Briefs + 90 days)

**AT&T California's Answer:** AT&T California proposes the following schedule:

AT&T California's Answer to Complaint: Jan. 23, 2014

AT&T California's Motion to Dismiss: Jan. 23, 2014

TURN's Response to Motion to Dismiss: Motion to Dismiss + 15 days

AT&T California's Reply to Response to Motion to Dismiss (if ALJ grants permission): Motion to Dismiss + 25 days

Ruling on Motion to Dismiss: TBD

Prehearing Conference (if necessary): Ruling on Motion to Dismiss + 20 days

Initial Briefs: PHC + 45 days

Reply Briefs: PHC + 75 days

Draft Decision: TBD

75. **TURN's Allegation:** Should the Commission determine that there are material factual issues in dispute, TURN reserves the right to propose a different schedule that includes opportunity for discovery, submission of prepared testimony and evidentiary hearings.

**AT&T California's Answer:** If its Motion to Dismiss is denied, AT&T California likewise reserves the right to request to seek discovery, file written testimony, or ask the Commission to hold evidentiary hearings.

To the extent AT&T California has not expressly admitted or denied based on lack of sufficient information or belief any allegation in the Complaint, it denies all such allegations.

### **III. AFFIRMATIVE AND OTHER DEFENSES**

#### First Defense

The Complaint does not state facts sufficient to constitute a cause of action.

#### Second Defense

The Complaint does not adequately advise AT&T California or the Commission of the grounds of the Complaint as required by Rule 4.2 of the Commission's Rules of Practice and Procedure. Among other things, the allegations in the Complaint are not clearly stated. For example, the allegations refer generically to "AT&T" rather than one or the other specific defendant, and therefore do not satisfy Commission Rule 4.2(a).

#### Third Defense

The Complaint does not comply with Public Utilities Code Section 1702 and Rule 4.1(b) of the Commission's Rules of Practice and Procedure

#### Fourth Defense

The activities of AT&T California are and continue to be consistent with the law, the Commission's orders, and AT&T California's tariffs.

#### Fifth Defense

Complainant's claims are barred in whole or in part by waiver, estoppel, and/or laches.

#### Sixth Defense

TURN's request for rate refunds is barred by the "filed tariff" doctrine and the rule against retroactive ratemaking.

Seventh Defense

AT&T California cannot fully anticipate at this time all defenses that may be applicable. Accordingly, AT&T California reserves the right to assert additional defenses if and to the extent such affirmative defenses are later discovered and found to be applicable.

Dated this 23<sup>rd</sup> day of January, 2014

Respectfully submitted,

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/s/

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Counsel for Defendant AT&T California (U 1001 C)

## VERIFICATION

I, Kenneth P. McNeely, under penalty of perjury, certify as follows:

I am an officer, to wit, President for Pacific Bell Telephone Company, doing business as AT&T California, a corporation, and make this verification for and on behalf of said corporation.

I have read the foregoing **ANSWER AND DEFENSES OF PACIFIC BELL TELEPHONE COMPANY (U 1001 C) d/b/a AT&T CALIFORNIA TO THE COMPLAINT** in C.13-12-005. I declare under penalty of perjury that the contents thereof, and the facts therein stated, are true to the best of my knowledge, information and belief.

Dated at San Francisco, California this 23<sup>rd</sup> day of January, 2014.

/s/

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**Kenneth P. McNeely**